

# **Report of the auditor-general to the to the Limpopo Provincial Legislature and the council of the Modimolle Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Modimolle Local Municipality set out on pages 2 to 88, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer's responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA) for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Cash and cash equivalents**

6. I have identified reconciling items to the amount of R 3 369 429 (2014: R11 918 968) which were cleared before year-end, but were still reflected on the year-end bank reconciliation as uncleared reconciling items. Consequently, cash and cash equivalents stated at R6 473 675 (2014: R6 792 665) in note 13 to the financial statements is overstated by R3 369 429 (2014: R11 918 968). Additionally, there is a consequential impact on the accumulated surplus.

### **Value Added Tax (VAT)**

7. The municipality has not reconciled its year-end VAT liability disclosed in note 20 to the financial statements amounting to R 30 139 824. My audit revealed an unreconciled difference between the general ledger balance and the amount according to the unpaid VAT 201 returns amounting to R3 310 507 (2014: R3 425 216). Consequently, the VAT liability as disclosed in note 20 to the financial statements amounting to R30 139 824 is overstated by R 3 310 507 (2014: R3 425 216). Additionally, there is a consequential impact on the accumulated surplus.

### **Prior year corrections**

8. Included in prior year corrections in note 41 is an amount of R4 142 073 in respect of a cash book balance which were previously not recognised in the accounting records of the municipality. Details of the transactions supporting the cash book balance were not provided for audit purposes, and the municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments relating to the prior period correction stated at R4 142 073 in financial statements were necessary. Additionally, there is a consequential impact on the accumulated surplus.

## **Opinion**

9. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Modimolle Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with requirements the SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

10. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Restatement of corresponding figures**

11. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2015 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

## **Material losses**

12. As disclosed in note 51 to the financial statements, material losses of 26.65% (2014: 26.55%) relating to electricity distribution losses and 30.07 % (2014: 19.39%) relating to water distribution losses were incurred as a result of ageing infrastructure.

## **Unauthorised and irregular expenditure**

13. As disclosed in note 44 to the financial statements, unauthorised expenditure of R23 802 291 was incurred in the current year as a result of overspending its budget.
14. As disclosed in note 46 to the financial statements, irregular expenditure amounting to R41 580 053 was incurred in the current year due to transgressions of SCM regulations.

## **Additional matter**

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Unaudited supplementary schedules**

16. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

17. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the Modimolle Local Municipality for the year ended 30 June 2015:
  - Development priority: Promote welfare of the community on pages x to x
  - Development priority: Resource management and infrastructure services on pages x to x
19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected development priorities are as follows:

### **Development priority: Promote welfare of the community**

#### Usefulness of reported performance information

#### Indicators and targets are not consistent

23. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 55% of the reported indicators and 60% of targets were not consistent with those in the approved integrated development plan. This was due to change of indicators and targets during the year.

#### Changes to targets and indicators not approved

24. Section 54(1) (c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to changes not being submitted to council for approval.

#### Target and indicators not well defined and not time bound

25. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 50% of the indicators and targets were not well defined.
26. The period or deadline for delivery of targets should be specified as required by the FMPPI. A total of 92% of the targets were not time bound.

### Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of standard operating procedures or documented system descriptions for the accurate recording of actual achievements and technical indicator descriptions for the accurate measurement, recording and monitoring of performance and monitoring of the completeness of source documentation in support of actual achievements and frequent review of the validity of reported achievements against source documentation

## **Development priority: Resource management and infrastructure services**

### Usefulness of reported performance information

#### Reported indicators and targets not consistent with planned indicators and targets

28. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 45% of the reported indicators were not consistent with those in the approved integrated development plan. This was due to change of indicators and targets during the year.

#### Changes to indicators and targets not approved

29. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to changes not being submitted to council for approval.

### Performance targets not time bound, well defined and verifiable

30. The period or deadline for delivery of targets should be specified as required by the FMPPI. A total of 57% of the targets were not time bound.

31. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 43% of the indicators were not well defined.
32. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 86% of the indicators were not verifiable. This was because management did not adhere to the requirements of the FMPPI and due to a lack of proper systems and processes and technical indicator descriptions

### Reliability of reported performance information

33. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information the auditee's records not permitting the application of alternative audit procedures.

### Additional matter

34. I draw attention to the following matter:

### Achievement of planned targets

35. Refer to the annual performance report on page(s) x to x and x to x] for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs x to xx of this report.

### Compliance with legislation

36. I performed procedures to obtain evidence that the Modimolle Local Municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows: I did not identify any instances of material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA.

### Strategic planning and performance management

37. The performance management system did not provide for policies and procedures to take steps of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.
38. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and the *Municipal planning and performance management regulations* 12(1) and 12(2)(e).

39. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
40. The annual performance report for the year under review did not include a comparison of the performance with set targets and/or comparison with the previous financial year and measures taken to improve performance as required by section 46 (1) (b) and (c) of the MSA.

## Annual financial statements, performance and annual reports

41. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

## Procurement and contract management

42. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by *Supply Chain Management (SCM) regulation* 19(a) and 36(1).
43. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
44. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
45. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) the code of conduct for councillors and staff members issued in terms of the MSA..
46. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

## Expenditure management

47. Reasonable steps were not taken to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.
48. Money owed by municipality was not always paid within 30 days, as required by the section 65(2)(e) of the MFMA.

## **Internal control**

49. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

## **Leadership**

50. Management designed controls to prevent non-compliance with laws and regulations. However, these were not adequately implemented and reviewed throughout the year. Action plans were developed but not fully implemented, hence the recurrence of findings identified in the prior year.

## **Financial and performance management**

51. A lack of adequate technical knowledge within management with regard to the preparation of financial statements and a lack of adherence to laws and regulations resulted in the qualified opinion on the financial statements.
52. A lack of technical knowledge in the finance section with regard to new accounting standards and legislation applicable to the municipality to adequately perform their functions relating to regular reconciliations, adherence to laws and regulations and reporting against predetermined objectives.
53. There is no monitoring of controls within the performance management process to ensure performance against predetermined objectives is useful and reliable.
54. The municipality has not developed a fraud prevention plan which should include specific measures for preventing and detecting fraud

*Auditor-General*

Polokwane

30 November 2015



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